Between continuity and paradigm shift: pension reforms in Germany

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ZeS-Arbeitspapier Nr. 14/03

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*) Paper prepared for the Workshop *Social Policy Responses to Population Ageing in the Globalization Era*, Hokkaido University, Sapporo (Japan), February 27 to March 1, 2003. It was revised in May 2003 and will be published in a Japanese anthology in 2004.

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ZeS-Arbeitspapiere
ISSN 1436-7203

Abstract

In general, the policy domain of old-age pensions is characterized by institutional continuity and only incremental reforms. Since the late 1980s, in Germany a series of public pension reforms, all initiated in view of imminent population aging, have happened. In this paper it is looked into the process and content of reforms legislated between 1989 and 2001 in order to understand the nature of change and its driving forces. The main question to be answered is whether these single reform steps eventually amounted to a “path departure”. Despite the reforms the public pension scheme will continue to be the central component of retirement income for the next decades to come, and traditional features of that social insurance program remained intact. However, it can no longer be regarded as a coherent and undisputed policy paradigm: pension politics has become increasingly conflictuous, and the scope of policy-making has widened from public pension policy (parametric reforms concerning a tighter contribution-benefit link, prolonged working life, adjustment formulae etc.) to retirement income policy. Thereby some of the public scheme's established principles have been abandoned, non-public components of retirement income are pushed and new actors become involved in the politics of pensions. It is thus justified to speak of a paradigmatic change that has occurred.

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1 Introduction: the Problem

All nations within the OECD area are confronted with demographic aging as a result of increasing life expectancy and of fertility rates having declined to below-replacement level. Among the institutions most heavily affected by the aging process is *old-age security* – pension schemes and other programs disproportionately utilized by the elderly, as are health and long-term care services. The combination of an ever more elderly-biased age structure and a shrinking population of what presently is defined as *employable age* pose severe problems for a welfare state which, in its expenditure orientation, is elderly-biased anyway.

Germany is among the Western countries where the fertility rate has been very low since about the mid-1960s. As a consequence, the size of population is going to shrink, from presently 82 million to 75 million in 2050 (see *Table 1*). As longevity is increasing, a dwindling population goes along with a rising share of elderly. The percentage of elders (60+) already exceeds that one of the young generation (<20) since the 1990s, and according to the latest official projections, more than one third of the population will be 60 years of age and older in 2030 and thereafter (see *Table 1*).

Pensions are the largest item of social spending on the elderly. Regardless of their funding method and whether they are public or private, their total costs for the economy in any given year exactly correspond to the net expenditure on this purpose (Thompson 1998). If one starts from a continued *actual* retirement age of about 60 years, it is obvious that compelling an ever smaller working age population[1] to finance pension benefits for a growing percentage of the population for an ever longer period of their lives means a serious political challenge.

This challenge which is about maintaining or restoring *generational equity* will hardly be eased by a declining share of young people who are also dependent on income support as long as they are still children or involved in education. *Table 1* shows the interesting fact that, in case the projected figures come true, the *total dependency ratio* in 2050 will be almost the same as it was 100 years ago when Germany was incomparably less wealthy. For one thing, many more youngsters below age 20 were actually in the labor force then and, almost regularly, older employees continued working until death or disability since pensions were low and explicitly meant to *supplement* other resources. More important is, however, that spending on the young generation is mainly private, i.e. by sharing the family's resources. Compared to the elderly, public spending per capita on the young is *substantially* less although, in cross-country comparison, to a varying degree (Lynch 2001; Esping-Andersen/Sarasa 2002). Hence, population aging remains a challenge for matured welfare states which, by now, have “grown to limits” (Flora 1986) and add to other strains they are facing: lower growth rates as post-industrialism progresses, structural changes in the labor market (decline

[1] The potential labor force in Germany will start to decline after 2010 even if a higher participation rate of women and an extremely high net migration are presumed. According to the most realistic scenario (assuming net migration of 100,000 persons p.a.), between 2010 and 2040 the potential labor force is going to decrease from 40.5 to 29.9 million persons what is about 25% (Fuchs/Thon 1999: 6).

of the “standard employment relationship”), more diversity in private (family) households and, finally, *globalization*. Paul Pierson (1998) has questioned whether globalization indeed represents an *autonomous* cause of pressure on welfare states and a major threat to their central features. However, being framed in the globalization context, the pressure on political actors in the welfare state to tackle the aging problem through pension reforms is reinforced. At least in threefold manner globalization is effective in this respect.

****** *Table 1* about here ******

First, globalization means a rapidly growing volume and intensity of cross-border transactions regarding goods, (financial) services, capital investments and, moreover, information flowing almost without a time difference. Epistemic communities are part of an increasingly transnational exchange of information. Their role in the political discourse on potential responses to demographic aging and the future of (public) pensions has increased, and it is further fuelled by interference of supranational organizations (like the World Bank, the International Monetary Fund or the OECD). This is so because the interest in “successful” or “innovative” pension reforms abroad and to adopt “best practices” has grown.

Second, recent pension reforms in developed nations regularly imply a larger role of (mostly private) funded schemes and, for the time being, more savings to be invested most profitably. In view of largely liberalized (deregulated) financial markets, pension funds and other institutional investors have become global actors when they operate worldwide and on a still growing scale. These multinational corporations and/or corresponding interest associations are attempting to gain a stake in the discourse on pension reform and to influence the direction of the reform process.

The third relationship between globalization and population aging *viz.* pension reform is particularly relevant for Germany as *the* “social insurance state” *par excellence*: in no other OECD country, contributions to social insurance schemes make up such a large share of GDP as in Germany, namely, 18.9% in 2001 which is about 43% of total public revenues (Bach et al. 2002; see also below, *Table 3*, col. 2). High regressive taxes on employing labor are presumed to have two effects: *(a)* Particularly jobs yielding low productivity are endangered to be substituted for by capital. This risk will increase when, due to aging, contribution rates to the public pension scheme as well as to statutory sickness funds and long-term care insurance have to be raised. Fewer jobs for low-skilled workers would shrink the contributory base, increase outlays (unemployment benefits) and, thus propel a vicious cycle. *(b)* Since social insurance contributions are partly shifted forward into labor costs, a country like Germany is prone to lose out on “locational competition”, i.e. to be no place of profitable investment and production anymore. In a globalized economy high total wage costs may not only scare off investors of capital, but also employees if it means a high tax wedge as well: it could cause a "brain drain" of domestic workers with a high earnings potential[2] and, *vice versa*, make Germany a comparatively less attractive place for potential immigrants. The influx of preferably young and well-educated migrants is a most important strategy to *moderate* the effects of demographic aging. Framing the aging issue in the globalization context thus urgently calls for pension reforms which contain the combined contribution rate to the social insurance schemes.

Unfortunately, of all programs in a welfare state a pension scheme that is organized as a social insurance is the one most resistant to reforms. According to Titmuss (1976: 60), "contributory 'rights' and privileges, spanning perhaps fifty years, become sacrosanct". This is so because entitlements are "earned" through prior contributions and are regarded as "quasi-property rights". Moreover, the opportunities of workers to adjust to policy changes decline to zero as they approach retirement age. The metaphor of the "generational compact" is thus a conceptual arrangement meant to bridge the temporal cleavage between the stages of a complete adult life, ranging from first covered employment to the last pension benefit paid. Additionally, the "generational compact" signifies a self-reproducing cooperative solution for income redistribution: based upon serial reciprocity it ties together the elderly, being interested in fair as well as sufficient pensions, and contributing members of the working age generation who want to see their parents and, after all, themselves well provided with public pensions. Hence, public pension schemes regularly enjoy high esteem and support among citizens of all ages who thus add up to a *broad constituency*. Living up to current and future beneficiaries' expectations of reliable income security nonetheless poses a difficult challenge for public policy. In order to overcome *inertia* as an institutional feature of pension schemes, reform considerations of policy-makers in this area of social policy are typically shaped by a very long time frame, stretching well beyond one parliamentary period and entailing a specific pension *politics* of which one outcome regularly are attempts to distribute the consequences of adjustment over time, i.e. into the future. It requires to timely take action in view of imminent problems.

Germany started early to meet the challenge of an aging population and passed the Pension Reform Act 1992 (hereafter: *PRA92*) in 1989. After enacting the *PRA92* the assessment prevailed among political actors that no substantial legislative change had to be considered much before the year 2010. Actually, already when the *PRA92* was going into effect a changed interpretation of the scheme's financial viability in the short and long run began to spread. It became the starting point of a series of further *structural* reforms. They are dealt with in section 3. To begin with, however, in section 2 the general spectrum of parametric reform policies is scanned and partly enriched with data relevant for the financial situation of the German public pension scheme.[3] Since the dominant

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[2] Another "drain" may happen if employees evade taxes and social security contributions by turning to clandestine employment in the informal sector.

[3] The "public pension scheme" in Germany compulsorily covers all white-collar and blue-collar workers above a certain earnings threshold and, additionally, the artisans (other self-employed may join voluntarily). Civil servants (almost 6% of all employed persons) are provided for through a uniform, tax-financed program without own con-

direction of pension reform is retrenchment those issues like institutional trust (reliable income security) and the legitimacy of the pension scheme are important. Therefore, in the fourth section the pension reforms in Germany are evaluated from the point of view of policy-makers' strategies vis-à-vis the perceptions of policy-*takers* and whether in 2001 a paradigm shift has taken place. Finally, in section 5, the German reform policy is briefly put in comparative perspective when looking at countries having pursued a social insurance approach as well.

2 Pension Reform Policies: the Repertoire

After the structural reform of 1957 the German public pension scheme became strictly earnings-related and based on pay-as-you-go financing (see section 3.1). Like in other countries with a comparable arrangement, the basic parameters to attain a balance of revenues and expenditures are quite few. In reality, due to the schemes' evolved complexity, a multitude of “adjustment screws” can be moved without transgressing the boundaries of parametric (or “system-immanent”) reform. Nonetheless, there is always a limited repertoire of reform options available for rebalancing expenditures and revenues (Chand/Jaeger 1996). These policy changes can affect either the insured (contributors), the pensioners, or the state's engagement in terms of co-financing (or, indirectly, by improving the framework conditions), or, according to De Deken's (2002) three-dimensional classification, they can relate either to payments, persons, or time. The scope and the mix of adjustment strategies, and thus eventually the allocative and distributive outcome, is determined by the respective institutional design as well as by the interests of the political actors involved, i.e. *pension politics*.

The most basic equation can be written as follows:

$$\boldsymbol{c} = (\boldsymbol{R} : \boldsymbol{E}) \times (\boldsymbol{P} : \boldsymbol{W}) \times (1 - \boldsymbol{S})$$

In principle, it could be decided politically that the contribution rate (***c***)[4] is always the dependent variable, i.e. moving up and down according to changes happening on the other side of the equation. The pursuance of such an “expenditure-oriented revenue policy” is viable due to the state's “power of compelling successive generations of citizens to become insured” (Beveridge 1942: 13) and, as Feldstein (1975: 78) added, “future tax rates can be set so that tax revenues are sufficient to meet the claims of the beneficiaries … *as long as the voters support the social security system”* (italics in

tributions. Farmers are included in a special scheme, and the professionals (doctors, lawyers etc.) have to join non-public pension funds.

[4] The other terms of the equation are: ***R*** = number of retirees drawing pension benefits; ***E*** = number of workers in covered employment; ***P*** = average pension level, ***W*** = average wage level of covered employees, ***S*** = state subsidy as a fraction of the pension scheme's total expenditure.

original). Since the level of ***c*** has repercussions on the development of terms on the other side of the equation (the number of workers in particular) it might be advisable to abstain from such policy and, all over, pension reforms exactly aim at containing an increase of ***c*** as a result of population aging.

Demographic conditions as such are not decisive, but rather it is the ratio of retirees and contributors, i.e. ***R* : *E***. Increasing the employment rate would be advantageous, but almost the opposite happened in Germany: the overall rate (15 to 64 years) remained roughly constant between 1970 and now (see *Table 2*, col. 1) despite more women having entered the labor force. The corresponding decline is limited to men, particularly in the higher age brackets (55 to 64 years – see *Table 2*, col. 2), and is largely due to the deteriorated labor market situation that started about the mid-1970s and still continues. A successful employment policy that actually reduces the number of workless persons (rather than substituting more early retirees for fewer young unemployed) and integrates more women of employable age into the labor market improves the revenue situation. Another strategy to enlarge ***E*** is to make gainfully employed but not yet covered persons liable to contribution payments (in Germany one could think of civil servants and certain groups of self-employed). It would increase revenues until the newly insured are going to claim benefits themselves.

****** *Table 2* <u>about here</u> ******

Further life expectancy at effective retirement age determines the number of retirees (***R***) and the duration of drawing benefits. While working life has been compressed (one must not forget an on average longer period of schooling and training), retirement has been extended: average age of entry into retirement is about one year lower (1.7 years for men) than in 1970[5], and life expectancy at age 60 has increased by four years since then (see *Table 2*, col. 3 and 4). Correspondingly, pensioners who deceased in 2001 have drawn their benefits more than five years longer than the generation thirty years ago – an increase of almost *50 percent* (see *Table 2*, col. 5). Any successful attempt that closes the gap between the actual and standard retirement age (which is 65 years since 1916) would moderate the future increase of ***c*** as ***R*** was reduced. It is a most effective strategy since the contributory period is lengthened and, at the same time, the period of drawing benefits is reduced. The policy levers are to abolish early retirement options, to make premature benefit receipt less attractive (permanent deductions from the pension benefit) or postponing retirement more attractive (actuarial supplements). Another strategy to change the beneficiary ratio would be to raise the statutory retirement age – either arbitrarily or indexing it to increasing life expectancy (Schmähl/Viebrok 2000). In both cases only the newly retired were affected while current retirees who also benefit from lower mortality rates are exempted.

[5] "Average retirement age" relates to all pathways leading to benefit receipt (disability and old-age pensions) except for survivors' pensions. – The extremely low figure for 1960 (despite full employment) was due to poorer health of elderly workers mainly as a result of World War II.

The term ***P* : *W*** within the equation denotes the standard or target replacement ratio. It is realized via the benefit formula, and regularly, three factors are included which determine the level of an old-age or disability pension: (1) the assessed income, (2) the length of the contribution period, and (3) the accrual factor (OECD 1988: 67-74). The concrete options for change are largely contingent upon the construction of the benefit formula. While the development of ***W*** is hardly open to political intervention, the benefit level (***P***) can be reduced across the board or selectively (e.g. in progressive fashion so that retirees hitherto entitled to a high pension are hit harder). The adjustment formula for current benefits provides one lever: Any change that reduces the periodical indexing rate to one *below* the growth of wages – be it the consumer price index or an arbitrary combination of parameters – saves on expenditure and does so quite substantially due to the "basis effect". However, a deviation from wage indexing implies that the timing of retirement becomes crucial: in a dynamic economy with wage growth, current beneficiaries lag behind the longer they are retired.

It is also conceivable to tie the benefit level to increasing life expectancy so that an assumed constant sum of pension benefits is spread over more retirement years. That was exactly the idea of the so called "demographic factor" which was part of the Pension Reform Act 1999 and would have affected newly and already retired persons, both enjoying more work-free years, in like manner (see section 3). In any case, a decrease of the benefit level has to be moderate or, at least, not abrupt since workers approaching retirement age (or being retired already) have hardly any opportunity to adjust to a lower than expected (or accustomed) level of public benefits. Moreover, this strategy is limited insofar as work incentive problems might emerge if, many more often, an earnings-related pension benefit is close to or even below means-tested social assistance one would be entitled to (see also Schmähl 2001) – in Beveridge's (1942: 141) words: "assistance … must be felt to be something less desirable than insurance benefit; otherwise the insured persons get nothing for their contributions."

Related to ***W*** there exists the option to increase the ceiling up to which contributions are levied. Without changing ***c*** more revenues accrue when additional parts of high earnings are made subject to contribution payments. In Germany, this strategy was applied exactly at times when the budgetary strain of the public pension scheme increased as it was true in the late 1970s/early 1980s, after unification and in 2003 (see *Table 3*, col. 5). Eventually, with a time-lag, it leads to higher expenditure if covered earnings are completely assessed in the benefit formula.

The repertoire of parametric pension reform strategies is completed by those strategies related to ***S***. Tax-financed subsidies can be either unspecific (e.g. a certain percentage of the scheme's expenditure or as an amount that covers annual deficits when they arise) or they can be meant to reimburse the scheme for non-contributory elements of the benefit package. In that case ***S*** represent fictitious contributions on behalf of insured persons who are/were unable to contribute to the scheme out of own earnings (e.g. during periods of military service or caring for small children). Whether it is economically more favorable (or distributionally just) to raise ***c*** or ***S*** and thus taxes instead depends upon the tax incidence and, hence, allocative and distributive considerations.

The larger ***S***, particularly for unspecific (non-earmarked) purposes, the more it becomes endangered at times when budgetary competition with other spending items gets fiercer. Furthermore, benefits may be in jeopardy as well because the less they are "earned" through prior earmarked contributions but are financed out of taxes the harder differentiated benefits can be justified: the distribution of benefits according to the equivalence principle is a characteristic feature of a social insurance scheme, whereas a tax-transfer scheme may hand out benefits according to either the need or the equal rights principle, i.e. in any case not differentiated due to prior or future tax payments.

3 Aging and Public Pensions in Germany: the Actual Responses

3.1 The Starting-point

Right from the beginning in the last decade of the 19th century, benefits from the German public pension scheme were linked to preceding contribution payments. However, the level of benefits emanating from this static scheme were low and, hence, "being old" was – for low-skilled blue-collar workers in particular – synonymous with "being poor" although, partly representing remnants of *Bismarck's* original concept of a tax-financed flat-rate pension, the scheme still contained elements of basic security until 1957 (Döring 2000).

The pension reform of 1957 had an *immediate* impact on the economic well-being of current retirees when the benefit formula and the post-retirement adjustment of benefits were made dynamic (Hinrichs 1998). Taking into account individual, lifetime earnings in relation to average earnings of all insured (thereby granting credits for military service, spells of unemployment and education) when calculating the pension amount and annually upgrading it according to *gross* wage growth made the retirees participating in economic progress. The benefit increase of more than 60% in spring of 1957 transformed public pensions as a floor of retirement income into an actual wage replacement that went up to a higher ratio subsequently (see *Table 3*, col. 4). Although basic security elements were abolished completely, the number and rate of elderly people being dependent on (additional) social assistance benefits declined, particularly after the expansionary reform of 1972 when, among others, internal redistribution was enhanced: a revaluation of covered earnings below 75% of average favored low-paid workers with long employment careers (and their surviving widows). It is hardly surprising that the structural reform of 1957 not only meant to be the "cornerstone" of post-war social policy reform in Germany but, due to the windfalls all current pensioners experienced, also stands out as its most popular element. It substantially contributed to the support for the new *economic order* of "social market economy" and further consolidated the legitimacy of the restored *democratic system* in general.

****** *Table 3* <u>about here</u> ******

In conclusion, not earlier than 1957 the old-age income system attained its specific shape that is usually associated with Germany as the prototype of a conservative welfare state regime: providing status maintenance at a high level for the male, full-time employed breadwinner after a full occupational career through a public scheme that is strictly earnings-related and hardly re-distributing in the vertical dimension. Although features of continuity (or: *path dependence*) pre-vailed, at the same time, the reform of 1957 meant, a *new* pension system was established (Conrad 1998; Döring 2000).

3.2 Containing the Future Rise of the Contribution Rate: General and Selective Retrenchments Between 1989 and 1997

Increasing outlays and declining contribution revenues out of actual earnings beleaguered all social insurance schemes in Germany after the “sudden death” of full employment in 1974. In the public pension scheme, additionally burdened with the costly consequences of the reform of 1972, this pressure implied a series of discretionary interventions resulting in a *factual* net wage development of pensions after 1977. Preceded by a, in principle, non-controversial debate on the implications of demographic aging and the need for timely action, eventually in 1989 another structural reform passed the legislative bodies with the consent of the largest party in opposition, the Social Democrats, and both social partners (*PRA92*). At that time the equally non-acceptable alternatives either were to exempt retirees from any benefit cuts, and then gradually have to increase the contribution rate from about 18.7 to 36.4 percent by 2030, or to cut benefit levels by half while maintaining a stable contribution rate. The cumulative effect of the altogether incremental reform elements should reduce the increase of the expected contribution rate by almost 10 percentage points (Schmähl 1993; Sozialbeirat 1998: 242).

The difference to the pre-reform projections mainly stemmed from the three changes mentioned first in *Figure 1*. The central idea of the new indexing formula was to ensure a stable net replacement rate of 70% (after 45 years in covered employment and constantly earning an average wage) and to make pensioners participating in demographically (or otherwise) induced alterations of social insurance contributions and income tax codes that would change employees' net wages. At first glance, a permanent deduction of 3.6% for each year of premature retirement seems not much of a disincentive for retiring before age 65. However, no credits are earned for those years (or months) not spent in covered employment anymore. It adds about 2%, but it is still contested whether the deduction is actuarial or not (Börsch-Supan/Schnabel 1999; Ohsmann et al. 2003).

****** *Figure 1* <u>about here</u> ******

When this structural reform became effective in 1992, the "unification boom" was almost over in West Germany and employment in East Germany was still in steep decline. The deteriorating labor market situation resulted in a nearly exploding influx into an early retirement scheme for elderly unemployed (starting at age 60). The concomitant rise in social spending and the increased contribution rates to the social insurance schemes can be read off from *Table 3*. This development contributed to another round of retrenchments of the public pension scheme being included in an omnibus bill enacted in 1996 (*WBG* – see *Figure 1* for the main elements). It enhanced the effects of the *PRA92* when it accelerated the phasing-out of early retirement options without permanent benefit deductions and further reduced various non-contributory entitlements. The Social Democrats and the unions vehemently opposed these changes (and further elements of the omnibus bill, e.g. waiting days for sickness benefits). The passing of this law in parliament and the subsequent preparations for another structural pension reform (*PRA99*) by the Christian-Liberal government marked the end of the traditional "pension consensus" between the two large parties and between the social partners – although there was no principled dissent on all changes included in the reform bill enacted in 1997.

For example, higher federal subsidies, financed out of an increased VAT rate (beginning in April 1998) and meant to cover non-contributory components of the benefit package more completely, were not contested as was a further improvement of child care credits (see below). However, the two most momentous reform elements of *PRA99* were, at the same time, the most controversial ones: *(a)* In order to push through a higher *actual* retirement age, individual efforts to evade permanent benefit deductions by resorting to *disability pensions* were made unattractive, and access to them was rendered more difficult. *(b)* Decreasing mortality rates at higher ages imply a hidden expansion of the scheme when newly and already retired persons enjoy more work-free years and a prolonged benefit receipt. Beginning in 1999, it was planned to integrate rising life expectancy at age 65 into the formula by which the *initial benefit level* as well as the *annual adjustment* is calculated. Further rising longevity assumed, the "demographic factor" would lower the *net* standard pension level from nearly 70 to 64 percent (but not below). The unions and Social Democrats objected to both changes, arguing that insured with lower than average earnings and/or a shorter than standard contribution record would increasingly see their pension benefits approaching or even falling below the social assistance level.

The government itself estimated that the legislative changes of 1996 and 1997 would further moderate the increase of the contribution rate: instead of 26.9% in 2030 a rate of only 22.4% was calculated, i.e. only two percentage points more the rate valid in 1997 (BMAS 1997: 16). Other projections arrived at (slightly) higher rates (see Sozialbeirat 1998: 242). Regardless of more funding out of general (and partly earmarked) tax revenues contributing to the diminished increase, future pensioners themselves will be the main "victims" of the aging process. The effects of the *single* reform elements legislated during the period in question are small in itself but their cumulative effect is much larger and not immediately visible. The scheduled decrease of the target replacement ratio, a widely used indicator of benefit generosity, only partly displays the most serious consequences on pensioners' benefit level and the overall distribution of benefits. The full impact hinges upon future pensioners' improved or diminished chances to realize a standard employment career and thus to earn credits sufficient for attaining the target replacement ratio. Employment careers are indeed changing (e.g. more frequent spells of unemployment and, in consequence, a retarded upward mobility of earnings, prolonged education leading to later entry into covered employment, or more frequent part-time work), and for the individual benefit level it is most decisive whether those developments are compensated for by corresponding adaptations of the entitlement rules or are aggravated when exactly those provisions aiming at social adequacy of benefits are removed.

3.3 From Public Pension to Retirement Income Policy

As announced by the Social Democrats before the 1998 election, the Red-Green government revoked the two most controversial elements of the 1997 reform package: (1) somewhat moderated impairments for potential disability pensioners went into effect according to a law enacted in 2000, and (2) the demographic factor, blamed as “non-social” and “pension cut”, was eventually replaced by discretionary manipulations of the benefit (adjustment) formula leading to roughly the same result in the long run, i.e. a standard replacement ratio of 64%. Since the definition of “net wage” has been changed the decline appears to be less large: the expected figure for 2030 is about 67%. Such tinkering with formulae shows that in a public defined-benefit scheme the benefit level is always *politically* defined. Shortly after entering office, the new government introduced a gradually increasing energy tax (*Ökosteuer*). The revenues are earmarked as a supplementary federal grant to the public pension scheme and made possible a reduction of the contribution rate to 19.1% in 2001.

The latest reform package (*PRA2001* – see *Figure 1*) passed the Bundestag in January 2001 and after further modifications the Bundesrat in May 2001. Three elements justify to speak of a *paradigmatic change* in Germany's old-age security policy although the outcome is almost negligible at present and for the next two decades or so.

(a) Like in most other pay-as-you-go, defined-benefit public pension schemes, in Germany the contribution rate was and will be increased when the available funds fall below a certain contingency reserve. In that respect, the reform legislated in 2001 actually means a reversal – a “revenue-oriented expenditure policy”. It stipulates a commitment of the government to take action when a contribution rate higher than 20% in 2020 and 22% in 2030 comes within reach. Apart from increasing the standard retirement age and (further) selective cuts, there are not many options left to live up to the legally fixed cap on the contribution rate development since the standard replacement ratio must not fall below the pre-defined threshold of 67%. It will be all the more difficult to

actually accomplish *both* ends because the assumptions on which the target figures are based were overly optimistic (due to the state of the economy it had to be increased to 19.5% in 2003 already).

(b) Among the 18 traditional OECD member countries, so far, only Germany has had no special minimum protection scheme for the elderly. Persons without sufficient insurance claims were referred to the general social assistance scheme. At the beginning of this decade only about 1.3% of retirement age people received those means-tested benefits. The official justification for introducing a special basic security scheme becoming effective in 2003 was to increase the take-up rate as the legal obligation of adult children to support their parents, is virtually lifted. This will be the immediate consequence, but in its explanation to the reform bill the government also admitted that changing (un-)employment careers might lead to more pensioners receiving benefits lower than the social assistance level (Bundesregierung 2000: 43). Along with the combined effects of various retrenchments enacted since 1989, there is every reason to assume an increasing number of new retirees whose insurance entitlements will be insufficient.

(c) Hitherto, retirement income policy in Germany was tantamount to public pension policy and a “one-pillar approach”. Presently, about 80% of total retirement income stems from unfunded public sources (when the civil servants' pensions are included). Other resources during retirement regularly bear a *supplementary* character. Outside the public sector, almost nowhere occupational pensions have been an element of industry-wide collective bargaining so far. Thus, coverage is comparatively low and, additionally, was on the decline for about 25 years. Private provision (personal pensions, income from assets) is on the increase but, like occupational welfare, it is predominantly a component in the benefit package of pensioners with formerly above-average earnings.

The central elements of the Red-Green pension reform are incentives for voluntary private provision which is meant to *compensate* for the declining target replacement ratio. Gradually increasing to 4% (in 2008) of gross earnings, contributions to certified savings plans providing supplementary pensions are tax privileged with a bias in favor of families with children and high-income earners. When the basic elements of the planned Red-Green pension reform were presented in June 1999, the proposal contained a 2.5% compulsory contribution to private funded schemes (as it was already legislated in Sweden). It was dropped almost immediately after massive protests and replaced with a voluntary variant and a higher savings rate recommended. However, in case participation in certified savings plans remains low, as a remedy, the government may make use of a provision already included in the *PRA2001* that would render possible an obligatory participation.

This reform element of *PRA2001* is an unequivocal expression of the turn towards a “multi-pillar approach” and an extension towards *retirement income policy* in Germany. This is so despite the fact that for birth cohorts retiring over the next three decades the proceeds from those new subsidized savings schemes will not contribute much to their total retirement income. If contributors to the public pension system follow the recommendation to save an additional 4% of their gross earnings for a personal pension and if these savings were to yield a constant interest rate of 4%, the personal pension accrual would amount to no more than about 12% of the standard public pension for a worker retiring in 2030. Albeit this component of the retirement income mix will be small in the beginning, it will enlarge economic inequality in old age because, in addition to a far from complete take-up rate, the private provision is of the “defined-contribution type” and contains no redistributing elements.

The pension reform of 2001 will, in case the government's rather optimistic assumptions come true, lead to a slightly lower contribution rate in 2030 than was expected by the Kohl government when it enacted its last pension reform in 1997 (see above). However, one has to add those 4% the *employees* are expected to voluntarily contribute to private pensions. Different from the public pension scheme (and to the trade unions' annoyance) the employers are exempted from joint financing. Such a higher contribution rate is unavoidable if one moves from a complete PAYGO system to partial funding and represents the well-known “double payment problem” that goes along with it.

In the short run the 2001 reform contains no real *additional* cuts, but in the long run a new architecture of the German retirement income system will be established. When one borrows from Peter Hall's (1993) classification of the magnitude of policy change, the reforms of the 1990s were first and second order changes which, by shifting *levels* and *instruments*, in a socially differentiated manner will threaten the receipt of a sufficient public pension. In contrast, the latest reform package explicitly abolishes the claim of the scheme to provide *status maintenance* through public benefits alone. In future, the employee has to save for a complementary private pension in order to attain this goal. The approach towards a multi-pillar system clearly represents a third order change – a *goal* shift (see section 4.3).

If one takes together all reforms enacted since 1989 there are three closely interrelated trends. First, the federal subsidy out of general and earmarked taxation to the public pension scheme has nearly doubled and presently amounts to about 30% of the scheme's pension expenditure, and more tax money will be spent on poverty alleviation after the implementation of the basic security scheme for pensioners. Second, the contributory principle in determining benefits has been strengthened: Non-contributory credits have been eliminated or reduced. If they are granted for certain periods of non-employment (sickness, unemployment) or of performing socially useful work (informal care of frail persons or raising children) actual contributions are paid by the government or the respective social insurance scheme. Thus, notions of *need* as well as of *desert* have been strengthened. Third, the introduction of child care credits in 1986, their extension for births after 1 January 1992 and a further revaluation enacted in 1997 (*PRA99*) and again in January 2001 (*PRA2001*) was the only expansionary element in the reform packages otherwise geared at retrenchment.

4 From Public Pension Reform to Old-Age Security Policy: an Evaluation

Very often, incumbent governments attempted to *claim credit* for an expansion of the welfare state. In particular increasing the generosity of pension benefit has been a preferred means to win electoral support. *Blame-avoidance* strategies denote the more complicated business of politicians to find acceptance for policy changes when no longer “good deeds” are at stake (Weaver 1986). However, the public does not always oppose curtailing public pensions or other welfare state programs. Roller (1996) mentions four criteria which, if fully met, ensure the public's acquiescence in austerity measures and minimize the threat of electoral retribution. Most likely, austerity measures are widely accepted among policy-*takers* if *(1)* their necessity as such is uncontested; *(2)* they are negotiated and (broadly) consented among the relevant political actors; *(3)* their impact is moderate or, at least, represent no systemic rupture; *(4)* ensure a socially balanced (fair) distribution of burdens. Mau (1998) adds a fifth condition: *(5)* that reforms debated and finally enacted are perceived as a coherent redesign of the scheme in response to a problem. Under these circumstances it is possible that institutional trust is restored or maintained. In this section I will evaluate the pension reforms in Germany between 1989 and 2001 in view of these five criteria.

4.1 The necessity of pension reform

The projected figures on population aging and the ensuing consequences were indeed so alarming and thus eased the task of policy-makers to credibly mediate a commonly shared “crisis diagnosis”. The unanimous problem definition and the proposed responses to the challenge being framed in a *globalization* and *intergenerational equity* context were used as an excuse for carrying out inevitable reforms and functioned as part of an overall blame-avoidance strategy. The imperative to take action did not, however, prescribe the concrete answers, but it was remarkable that it was presented as increasingly urgent even though the first “wave” of reforms was not even completely implemented.

4.2 The advantage of a pension reform consensus

Striving for a consented reform relates to the *process* of policy formulation: a shared understanding of *what* should be done implies that different social interests are taken into account in negotiations and thus a fair distribution of the consequences can be expected. Where pension reform was on the agenda, it was regularly attempted to attain oversized majorities (Hinrichs 2000a) or to act in agreement with the social partners. Governments' interest in winning over allies for a compromise is obvious: sharing the responsibility for tangible impairments affecting large parts of the electorate so that competing parties will not benefit from the public's possible discontent. But why are non-governing parties prepared to compromise and support loss-imposition? First, participating in a compromise may provide the opportunity to claim credit for successfully having prevented an even worse outcome (or hardships for a certain clientele). Second, always striving to come to power after the next election, the opposition parties cannot be interested to alone shouldering a protracted reform. Contrary to politicians usual inclination to engage in short-term fixes, in pension policy government parties and opposition parties alike might be motivated to adopt a long planning horizon and *not* to postpone "hardships" since they reappear in form of intensified reform urgency, but then with less leeway to spread the burden placed on policy-takers over a longer period via generous phasing-in/out provisions. Thus, procrastination does not pay off for no party.

In Germany, the structural reform of 1957 established a "pension consensus" which virtually meant two "Grand Coalitions" – one of the two *Volksparteien* (Social Democrats and Christian Democrats), the other grasping the social partners who always had, compared to other social insurance schemes, an almost uncontroversial stance towards this "flagship" of the German welfare state (Hinrichs 1998: 27). It is, of course, easier to attain a consensus when an expansion of the scheme is on the agenda, and the real threat is that government and opposition outbid each other's demands for amelioration as it happened in 1972 (see Hockerts 1992). The traditional consensus orientation of the two large political parties maintained when the *PRA92* was enacted in 1989, but eroded after the compromise on the pay-as-you-go long-term care insurance in 1994. The Social Democrat's resistance against the *WBG* and, subsequently, against the *PRA99* foreshadowed the 1998 federal election when, after 16 years of Kohl government, the opposition realistically hoped for a change of power.

With regard to the *PRA2001*, the Christian Democrats partly took revenge for the SPD's strategy to *successfully* blame the Kohl government for the "pension cuts" included in the *PRA99* during the 1998 election campaign.[6] More important, however, was that the CDU was in a very weak position from about end of 1999 until the beginning of 2001 when the scandal of the party's finances absorbed its leaders' attention and made them reluctant to compromise despite substantial

[6] Results from the 1998 exit polls are most telling. They show that voters of retirement age or approaching retirement disproportionately turned away from the CDU/CSU (Emmert et al. 2001: 33):

	Christian Democrats	*Social Democrats*
all ages:	35.2% (-6.2)	40.9% (+4.5)
age 45-59:	35.5% (-9.0)	42.7% (+6.0)
age 60+:	43.5% (-6.2)	40.1% (+5.8)

Losses for the Christian Democrats were particularly large among elderly women who, traditionally, had been the most loyal followers of that party. At the 1998 federal elections the pension issue ranked high among the electorate, and the Social Democrats were believed of being capable of "securing pensions" much more frequently than the Christian Democrats. It has to be admitted, however, that beside pensions, the statutory health care scheme was another important topic: the cuts enacted in 1996 and 1997 were immediately felt as higher co-payments for pharmaceuticals.

concessions of the Red-Green government as it responded positively to the CDU's demands. The lessons from the breakdown of the “pension consensus” in Germany during the 1990s are twofold: First, a reliable compromise requires a strong opponent, or concretely, a political party which can afford to renounce a possibly mobilizing theme during the next election campaign because, after a consented pension reform has been legislated, that issue is no longer utilizable. In contrast, a weak party is anxious for not to give away any theme that might possibly mobilize voters.

Second, compared to pension policy in other nations, the established consensus in Germany was not untypical, but possibly more pronounced. Despite recurrent conflicts it meant agreement regarding the normative commitment to the existing institution and its objectives and principles, jointly shared interpretations of reality and a focus on parametric adjustments within the given framework. The ability to pursue cooperative strategies was enhanced by two features, namely, that pension policy is a complicated and very technical affair and that a small network of experts with close interactions and commonly shared knowledge had been established. This network, capable of largely insulating the policy development from outside interference, consisted of representatives from *both* social partners, the schemes' administration, the Ministry of Labor and Social Affairs and, not the least, from the political parties. It was able to take a long time horizon the more the politics of pension policy was *de-politicized* and *deparlamentarized*. The latter condition was especially true of the *PRA92* when this mode of consensual pension policy-making culminated and a largely “conservative” reform package promoted the public's perception of time consistency.[7]

That situation changed around 1996 when *within* the two large political parties the pension issue surpassed a level of attention that made it impossible for the respective policy experts to keep down the discourse from flourishing. Moreover, during the long pre-election phase the pension issue became one of competition *between* the two parties. With ranks no longer closed in unanimous defense of the established *policy paradigm*, dissenting voices favoring radical changes became more frequent and listened to than before, thus enhancing insecurity on part of the public about reliable pensions in future.

4.3 Moderate impact – but paradigm shift?

Undoubtedly, an impairment of welfare state benefits one is accustomed to or expects to receive soon is unpopular. The grievance should be limited and the cut-back accepted more readily if the experienced loss is *moderate*. When assessing the magnitude of a policy change (or its *effects*) it is always difficult to define and, subsequently, to measure whether the reform was “moderate” (incremental) or “radical” (paradigmatic). The task to judge about the extent of reform becomes

[7] For an excellent analysis of the process of pension policy-making in Germany and the accompanying “policy community”, see Nullmeier/Rüb (1993).

even more difficult if a series of apparently incremental changes has been enacted and, moreover, the subject is pension reform. Present changes in expenditure are, to a large extent, the result of political decisions reached (very) long ago and, again due to the effects of phasing-in/-out provisions, recent reforms sometimes alter the expenditure and revenue situation with an extended time-lag. Moreover, changes in expenditure levels reflect the balance of program expansions and restrictions in the past as well as current demographic and economic changes so that a "steady state" will hardly ever be attained as long as pension reform policy remains a "never ending story". Likewise, the institutional history of the pension system is decisive for the income situation of today's retirees: it is the result of institutional arrangements valid when they were at working age and oriented their behavior to those (varying) rules, incentives or obligations.

It is suitable when measuring the extent of a policy change to distinguish between the *individually* perceived effects and the long-term perspective of a policy analyst interested in *aggregate* effects (and their distribution on the micro level). With regard to the public's perception any government should be anxious to convey to the public an image of a *moderate* adjustment and of institutional continuity. The most appropriate means are generous phasing-in/out provisions which reduce the number of immediate "losers". There are further strategies to conceal responsibility and the full impact of reforms: *automatisms* which trigger a certain response or (changed) *formulae* depoliticize the actual implementation of reforms and relieve today's policy-makers from being held responsible for retrenchment effects occurring later. In complex programs the "blessing of intransparency" (Zacher 1987: 590 and 594-5) impedes an exact calculation of the individual outcome of rule changes and provides another "blame avoidance" option that enlarges the scope for public pension reforms and minimizes their impact on subsequent elections.

Since there are no data available in Germany which measure the magnitude of recent pension reforms from an individual perspective I will turn to the policy analysis perspective. The argument is that, *(a)* up to the *PRA99*, the series of small policy changes have left the basic principles of the scheme intact but, eventually, the cumulative effects on the level and distribution of benefits will be substantial. *(b)* In contrast, the institutional redesign attained through the *PRA2001* will not change the long-term fiscal impact very much compared to the *PRA99* if it had been completely implemented. Nor will the *PRA2001* make future beneficiaries substantially worse off – on the contrary, if (younger) members of the public pension scheme save according to the recommended rates and cash in the subsidies, their total retirement income might still provide status maintenance. Nonetheless, the *PRA2001* can be characterized as a paradigmatic shift.

(a) Two empirical studies show the substantial cumulative effect of the *PRA92*, the *WBG* and the *PRA99*. The *AVID*-study (Kortmann and Schatz 2000) is based on an investigation of the hitherto earned entitlements (and private provisions made for old age) of a representative sample of singles/couples born between 1936 and 1955. The (future employment) behavior and (legal) parameters for the remaining years until reaching retirement age are modeled. Entitlements for *public* pension benefits will be lower for *men* of the youngest birth cohorts in West Germany (-

5%); for East Germans the decline will be even more pronounced (- 12%). Compared to the oldest cohort in question, *women* born in the early 1950s can expect roughly the same benefit level in East Germany, whereas in West Germany, on average, they will receive a significantly higher public pension (+ 16%). These results reflect the changed (un-)employment (and family) careers of men and women born within this 20-years period as well as to what extent the different birth cohorts will eventually be affected by retrenchments enacted so far. On both accounts (*West* German) women's entitlements will grow – particularly due to child care credits, introduced in 1986 and recurrently expanded thereafter.

The *PROGNOS* study (1999) forecasts public pension entitlements of cohorts retiring until 2040 as compared to those already retired in 1996 and assuming identical insurance careers for all cohorts. It solely focuses on the consequences of the legal changes enacted between 1989 and 1997. Generally, the benefit level of the youngest cohorts (retiring in 2020 and later) was estimated to be about 20 percent lower than of their counterparts who retired in 1996 and an even larger loss for those with earnings constantly below the average. In sum, the public pension scheme is not an immovable object, but rather proves considerable institutional elasticity and substantial effects as result of even incremental changes.

(b) The *PRA2001* has provided the tracks on which pension policy may smoothly move further away from the hitherto valid paradigm. Insofar, by creating the framework for individual pension plans, the Red-Green government has not merely made up something the preceding government had simply “forgotten” when it enacted the *PRA99* but offered nothing that would compensate for the gradually declining benefit level as a result of the “demographic factor”. Rather, by assigning a new role to the public pension scheme, the *PRA2001* marks a radical change – a *paradigm shift* (Michaelis/Thiede 2000; Schmähl 2002). Four interrelated innovations may prove this. First, the explicit goal of status maintenance (70% net replacement rate after a full employment career of 45 years) has been given up, and *new components* (subsidized private pension savings on the one hand, the poverty alleviating basic security scheme on the other) add up to a multi-pillar system in the making and leads to a true public-private-mix of retirement income. Second, *PRA2001* implies a *new mode of financing*: more state subsidies to attain socially adequate pensions as well as spending on the tax-transfer scheme preventing old-age poverty, increasing fiscal welfare to induce voluntary savings efforts which are not matched by employers' contributions, and predetermined caps on the contribution rate (max. 22%) to the public scheme. Third, *new actors* have gained a stake in retirement income policy (Hinrichs 2000b; Nullmeier 2001), as there are the various branches of the financial service industry offering the certified defined-contribution schemes, the Ministry of Finance which is involved with considerably more tax money than before, an authority regulating the emerging “welfare market” and its products, organizations protecting consumers' interests, and the social partners in a new role as they enter collective agreements on supplementary provision to be materialized as (more cost-efficient) occupational pensions. Fourth, a *new mode of policy-making* will gain ground since the model of a contributory, pay-as-you-go public pension

scheme that balances individual equity and income adequacy no longer serves as an uncontested point of reference for all actors rallying in this policy arena. After turning into retirement income policy the once closed community of *public* pension policy has lost its interpretative hegemony. The new retirement income policy will take place in different, partly parallel domains with conflictuous relationships among each other.

4.4 A fair distribution of burdens?

The perception of fairly shared burdens relates to single policy changes as well as to the overall *effects* of a reform. A reform *package* simultaneously affecting different groups seems to be more suitable to produce the impression of "fairness" and acceptance than a single measure that concentrates the loss. Thus, pension reforms regularly contain a bundle of changes, and a further advantage for policy-makers is that, if different groups suffer, the respective extent of suffering is hardly commensurable – at least not for the ordinary citizen who will, most likely, rest content with the perception of not being the only "victim". In case of pension reform, fair burden sharing has two dimensions, an *inter*generational and an *intra*generational.

"Intergenerational equity" was the catchword for the pension reforms in Germany aiming at a bearable contribution rate for future cohorts of employees. Indeed, as calculations carried out by the Deutsche Bundesbank (2001: 39-42) and Fehr/Jess (2001) show, the younger cohorts will gain from the *PRA2001* while the previous reforms have not improved their position (Borgmann et al. 2001). Particularly those estimations within the generational accounting framework (like the study of Borgmann et al. 2001 or Deutsche Bundesbank 2001) are rather crude. It is, however, quite obvious that due to the cohort-specific incidence of various phasing-in/out provisions the insured who are close to retirement age are the main losers: in case of early retirement they are the first ones to face permanent deductions; they lose out by the stricter link between contributions and benefits; and they can hardly benefit from subsidized saving for a supplementary pension but will, for the most part of their retirement years, suffer from the less favorable formula for annually indexing current benefits.

In *intra*generational perspective those with low earnings and more discontinuous, non-standard working career will bear a large burden due to the reduction or elimination of provisions aiming at "social adequacy" of benefits. For persons born between 1936 and 1955, entitlements derived from non-contributory credits amount to about 10% of the *average* insured's total entitlements (Bieber/Stegmann 2002), what shows the predominance of the strengthened *individual equity* principle within the public pension scheme. Regarding supplementary private pension, many low-wage workers will not be able or prepared to utilize the subsidized saving schemes that are meant to compensate the gradually decreasing replacement ratio of the public scheme. In contrast, many employees with higher earnings will simply shift savings in order to reap the tax advantages.

Furthermore, if no contributions are made during unemployment, sickness or disability, the annuity arising from those defined-contribution plans is lowered. This will negatively affect low-wage workers since the aforementioned risks are more prevalent among them. In sum, the more defined-contribution elements gain ground within the overall income retirement system the more the potential for redistribution declines and, consequently, income inequality in old age increases.

Nonetheless, there are winners from the series of pension reforms: families/women with children benefit from the gradually improved child care credits and the revaluation of credits out of own earnings when children were below 10 years of age. Moreover, since the amount of subsidies for certified pension savings plans is differentiated according to the number of children, families are enabled to shoulder a relatively smaller out-of-pocket contribution. The second group that won from *PRA2001* in particular are high-wage earners since they can deduct the pension savings from taxable income which is more favorable beyond a certain income threshold.[8] Another group of winners are the employers whose participation in compulsory contribution payments is scheduled to not exceed 11% of covered wages. Compared to the starting point in 1989 this cap implies a great relief since the employers do not have to recoup further increases of the contribution rate – and which are equivalent to a statutory wage rise – during the next rounds of collective bargaining. Finally, it is obvious that the financial service industry offering certified pension saving plans is the prime winner of the *PRA2001*.

4.5 A coherently designed response to population aging?

Instead of being threatened by electoral retribution political parties initiating retrenchments may gain *reputation* from pursuing foresighted, purposeful policies and increase their appeal to voters. One can safely assume, that a moderately reduced benefit level is preferred over an unchanged but, in future, less secure pension. The question, however, is whether the government's action that implies individual losses has been successful in restoring expectations of *security*. Survey research shows that support for public pensions and confidence in the security of public pension are still at odds – the latter low, the first strong (Dallinger 2002; Kohl 2002). Particularly the younger cohorts have not much trust in the reliability of public pensions but they do not cope with it by taking on certified pension savings plans to an extent that corresponds to the degree of perceived insecurity. At the beginning of 2003, only about one fifth of the eligible employees had signed a corresponding contract which is lower than expected beforehand (Schnabel 2003). Among others, the slow start may be due to the fact that insecurity extends to private pensions as well: which type of certified

[8] However, since earning a high wage regularly conditions more years of education, the reduction of non-contributory credits for periods spent in education as stipulated in *PRA92* and *WBG* meant lower entitlements for this group.

plan is most appropriate? What happens if individual circumstances change? Are the savings safe? These (and other) questions point to an information problem and lacking "financial literacy". As long as these deficits are not removed it should be difficult to convince the public that the government has delivered proper responses to population aging.

Another question, beyond the public's perceptions, is whether the pension reforms in Germany *actually* represent a coherently designed (consistent), appropriate and sufficient response to demographic aging. No definite answer is possible. It very much depends on the economic and/or political point of view. While the *PRA92* was almost unanimously judged as a necessary, appropriate and balanced step to be added on well after the year 2000, Social Democrats and the trade unions opposed a declining target replacement ratio as long as there were equivalent reform options accessible (see section 2). The trade unions stuck to their position regarding the benefit level, and when it came to supplementary private pensions they received support from further adherents of the (traditional pay-as-you-go) social insurance approach, all questioning the usefulness of prefunded pensions more or less vehemently (e.g. Urban 2000; Schmähl 2001; Ruland 2001).[9] Although the advocates of privatizing pensions and prefunding have become more silent since stock markets are not "bullish" anymore, they still propagate further shifts in the public-private mix of retirement income as more cost-efficient and necessary (e.g. Deutsche Bundesbank 2002). Other influential authors continue to paint a bleak future of the public pension scheme and demand much more private provision (Miegel et al. 2002 in a study commissioned by a subsidiary of the Deutsche Bank).

The ongoing debate on whether pensions are secure or further (radical) reforms are inevitable is important because pension policy has become an even more complex issue and is thus not easily understood even by trained journalists. Media communication *about* the sustainability of public pensions influences the stability *of* the public scheme (see the Feldstein citation in section 2). Alarmist reports are thus further undermining institutional trust independent of the factual appropriateness of recent reforms.

4.6 After the latest reform

The basic features of the public pension scheme that was enacted in 1889 when Bismarck was still Chancellor were recognizable after the reform of 1957, and this remains true even after the *PRA2001*. However, the then accomplished departure from a "one-pillar approach" with occupational or personal pensions simply *adding* to public, earnings-replacing pensions is irreversible. A

[9] In order to have the trade unions acquiesce in the *PRA2001*, the government finally inserted the provision that the standard replacement ratio must not fall below 67%. Moreover, there is every reason to assume that extending the rights of works councils later in 2001 as was demanded by the trade unions was another "price" the government had to pay for a smooth reform process.

once “coherent policy paradigm” (Hall 1993: 290) has been shaken and replaced with a “multi-pillar approach”. If further responses to demographic aging will be considered necessary in future, the direction will definitely be to further *substitute* public pension components with private provision, and as pension reform policy is a “never ending story”, those changes of the public scheme are already foreseeable.

The mode of taxing public pensions has to be changed according to a verdict of the Constitutional Court. Regularly, former blue- and white-collar workers pay no income taxes on their public pension (if they do not receive substantial income from other sources). Gradually, the mode has to be shifted to completely exempting (compulsory) contributions and taxing benefits instead. It can be expected that already during the transition period retirees with above-average public pensions will lose out. In 2002 the government appointed the “Rürup-Commission” which recently disclosed its proposals aimed at keeping the contribution rate below the 22% limit until 2030 (FAZ 2003).[10] They were positively embraced by the government. The main elements are introducing a variant of the “demographic factor” in the benefit (indexing) formula in 2005 and raising statutory retirement age to 67 years between 2011 and 2030. If actually realized, future pensioners would have to additionally save for private pensions in order to *compensate* for a lower replacement level or for the deductions that incur if one claims benefits earlier than the rising pensionable age. Again, this would shift the public/private mix of retirement income towards the multi-pillar approach.

5 The German Experience in Comparative Perspective: a Conclusion

One common trend of pension reforms in OECD countries has been the introduction or extension of provisions by which raising children (and thus interrupting or reducing employment) is somehow acknowledged when pension benefits are calculated (Hinrichs 2000a). Compared to other nations' provisions, child care credits in Germany are very generous and expensive since the government pays contributions on behalf of the parents.[11] At the same time, monetary transfers to parents (child allowances) have increased to a level that is only outperformed by Luxembourg, Austria and Belgium (Bradshaw/Finch 2002). Taken together, it is hardly a shining example of “women friendliness”. By further intensifying the transfer-heavy design of its welfare state, Germany has traded the opportunity to alternatively spend more on child care service which would ease a

[10] For the most recent legislation at the end of the year 2003 and the reform bills emanating from the “Rürup-Kommission”, see Hinrichs 2004.

[11] Factually, these payments amounting to about 450 EUR per month and child below age three help to keep the contribution rate on earnings as low as it presently is because they exceed expenditure for benefits based upon credits for births thirty and more years ago by the factor three. When extended credits for births after 1991 will have to first be honored about 25 years from now it will be the then grown-up children who pay for their parents' (speak: mothers') increased pension benefits.

simultaneous realization of parenthood and employment career. That strategy would yield sufficient pension entitlements accruing from more years spent in employment and, at the same time due to its positive job effect (Spieß et al. 2002), a more favorable pensioner/contributor ratio was attained.

Another common trend has been to make early retirement more expensive for the premature pensioner. This is hardly surprising as it is the “natural solution” in aging societies. It remains to be seen whether closing pathways into early retirement or increasing incentives to stay at work (at least) until statutory retirement age will be effective in reversing the trend in those countries where average retirement age has declined to about 60 years or even below (like in France, the Netherlands, Finland or Germany). Still prevalent seniority wages scales (OECD 1998) are a hindrance from the perspective of enterprises and keep up the interest to get rid of expensive, but less productive elderly workers. On the other hand, the long-term practice of a low effective retirement age has changed older workers' preferences in a way that age 60 (or even below) is increasingly considered as the “normal” pensionable age. It is thus well conceivable that, very often, both workers and their employers are interested to strike a deal so that a clear reversal is postponed until factual labor scarcity leads to a change.

The predominant implication of pension reforms enacted during the last two decades has been retrenchment and they have been initiated by governments of all “colors”. Is there nonetheless a “Social Democratic type” of pension reform to be observed? Apparently not, but only reform packages which apportion burdens and relief to birth cohorts and social groups according to political opportunism. One reason for not being able to detect a Social Democratic profile might be that originally present ambitions had been lost in the search for a broad consensus; another that the respective institutional shape of the retirement income system more or less confines the spectrum of accessible policy changes. This does, however, not explain the general trend towards private, funded pensions, and why it were exactly the Social Democrats who effected the paradigm shift in Germany. A possible answer goes like this: still in the late 1980s almost nowhere (outside the U.S.) proponents of “pension funding” had conquered a voice in the pension policy arena. In Germany at least, these economists were definitely a minority. The World Bank (1994) report, although primarily targeted at less developed countries, popularized the multi-pillar approach with funded components in its center as the proper response to population aging in OECD countries as well. One should always be cautious towards conspiracy theories, but economists and the financial services industry have become more capable of re-framing pension policy issues and contributed to the *goal shift*. Whatever their exact contribution to it was, in any case, no government could be sure to successfully push through further increases of contribution rates to *social* insurance schemes so as to *always* meet the consequences of population aging (see again the Feldstein citation in section 2). In contrast, supplementary funded private pensions result from *savings* and represent an *individualistic* solution to future risks associated with the level of pensions from a *collectivist* scheme. A “modernizing” Social Democratic party putting more emphasis on self-responsibility was poorly advised not to take into account *individualization* as a societal “mega-trend” and not to provide individual options.

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Table 1: **Population (Structure) in Germany: Development 1900–2000 and Projections 2010–2050 (Variant 5)**

Year	Population in million (1)	< 20 yrs. in percent (2)	≥ 60 yrs. in percent (3)	old-age dependency ratio[1] (4)	total dependency ratio[2] (5)
1900	56.4	44.2	7.8	16.3	108.5
1910	64.9	43.7	7.9	16.3	106.7
1939	69.3	32.0	12.3	22.0	79.6
1950	69.3	30.8	14.0	26.8	83.3
1961	73.7	28.1	17.8	33.0	84.9
1970	78.1	30.0	19.9	39.8	99.7
1980	78.4	26.8	19.4	35.9	85.6
1990	79.1	21.8	20.3	35.1	72.8
2001	82.4	20.9	24.1	43.9	81.9
2010	83.1	18.7	25.6	46.0	79.5
2020	82.8	17.6	29.2	54.8	87.7
2030	81.2	17.1	34.4	70.9	106.2
2040	78.5	16.4	35.2	72.8	106.6
2050	75.1	16.1	36.7	77.8	112.0

[1] elderly ratio = (population ≥60 × 100) **:** population 20 to <60
[2] total dependency ratio = [(population <20 + ≥60) × 100] **:** population 20 to <60

Sources: BMFS 1993: 257; Statistisches Bundesamt 2003: 42.

Table 2: **Development of Labor Market and Mortality Figures Relevant for the Financial Situation of Public Pension Schemes in Germany**

Year		employment rate (**15** to **64** years) (1)	employment rate (**55** to **64** years) (2)	average retire-ment age[1)] (3)	further life expectancy at age 60 (4)	duration of benefit receipt of pension-ers deceased in re-spective year[1)] (5)
1960	M			59.5	15.5	9.6
	F			*58.8*	*18.5*	*10.6*
	T			**58.8**		**10.1**
1970	M	89.2	78.9	61.6	15.3	10.3
	F	*46.3*	*28.3*	*61.3*	*19.1*	*12.7*
	T	**66.9**	**49.6**	**61.3**		**11.1**
1975	M	82.2	66.7	61.2		10.6
	F	*47.3*	*24.4*	*61.2*		*13.2*
	T	**64.4**	**41.6**	**61.2**		**11.6**
1980	M	81.1	64.1	58.5	16.5	11.0
	F	*49.6*	*27.2*	*59.8*	*20.8*	*13.8*
	T	**65.2**	**42.2**	**59.2**		**12.1**
1985	M	75.5	53.6	58.7		11.9
	F	*47.7*	*21.3*	*60.4*		*14.9*
	T	**61.6**	**35.5**	**59.5**		**13.1**
1990	M	75.7	52.0	59.5	17.8	13.9
	F	*52.2*	*22.4*	*61.6*	*22.1*	*17.2*
	T	**64.1**	**36.8**	**60.6**		**15.4**
1995	M	73.7	48.2	59.8	18.7	13.6
	F	*55.3*	*26.8*	*60.5*	*23.1*	*18.2*
	T	**64.6**	**37.4**	**60.1**		**15.8**
2000	M	74.8	48.2	59.8	19.2	
	F	*57.7*	*29.0*	*60.5*	*23.5*	
	T	**66.3**	**38.6**	**60.2**		
2001	M	73.0	45.4	59.9		13.8
	F	*58.6*	*28.4*	*60.5*		*18.9*
	T	**65.9**	**36.8**	**60.2**		**16.3**

[1)] 1960, 1970 and 1975 data for males and females relate to the blue-collar and white-collar scheme only (total figures also include the miners scheme).

Sources: **(1)** and **(2)** OECD: Statistical Compendium, Edition 01#2002 (CD-ROM); OECD 2002: 304-7, 310 and 313; **(3)** VDR 2003: 111-2; **(4)** Statistisches Bundesamt 2003: 16; **(5)** VDR 2003: 132-3.

Table 3: **Social Expenditure and Public Pension Financing in Germany**

Year	Social Expenditure in Percent of GDP **(1)**	Combined Contribution Rate to Social Insurance Schemes **(2)**	Public Pension Expenditure in Percent of GDP **(3)**	Net Standard Pension in 1995 EURO/*in % of Real Net Average Earnings* **(4)**	Contribution Rate to The Public Pension Scheme (*Earnings Ceiling in % of Gross Average Earnings*) **(5)**
1957		21.6			14.0 (*178.5*)
1960	21.1	22.4	6.4	5,517/*66.8*	14.0 (*167.2*)
1970	25.1	26.5	7.7	8,398/*65.0*	17.0 (*161.9*)
1975	31.6	30.5	9.8	9,995/*66.8*	18.0 (*154.1*)
1980	30.6	32.4	9.6	11,527/*71.1*	18.0 (*170.9*)
1985	30.0	35.1	9.5	11,171/*72.4*	19.0 (*183.6*)
1990	27.8	35.8	8.8	11,849/*68.0*	18,7 (*180.2*)
1991	28.4	36.7	8.9	11,902/*67.8*	17.7 (*175.6*)
1995	31.2	39.3	10.3	11,822/*69.9*	18.6 (*184.7*)
1996	32.1	40.8	10.5	11,733/*70.1*	19.2 (*185.8*)
1997	31.6	41.8	10.5	11,594/*71.0*	20.3 (*188.7*)
1998	31.5	42.1	10.6	11,552/*70.1*	20.3 (*190.5*)
1999	31.9	41.2	10.6	11,619/*69.9*	19.5 (*190.6*)
2000	31.9	41.0	10.7	11,537/*69.1*	19.3 (*190.2*)
2001	32.1	40.8	10.9	11,375/*67.7*	19.1 (*190.9*)
2002		41.3		11,440/*68.4*	19.1 (*189.4*)
2003		42.1			19.5 (*209.4*)

Sources: **(1)** = BMAS 2002: 19 and 22 [figures not comparable to OECD calculations; figures 1991 and after relate to united Germany]; **(2)** = VDR 2003: 243; **(3)** = BMAS 2002: 35 and 38; **(4)** = VDR 2003: 240 ["standard pension" is based on 45 years of employment at always average earnings; all figures relate to West Germany]; **(5)** = VDR 2003: 239 and 245 [1992 and after: contribution assessment ceiling valid in West Germany].

Figure 1: **Central Elements of Pension Reform Acts Legislated in Germany between 1989 and 2001**

Pension Reform Act 1992 (PRA92) – legislated: 1989; effective: 1992 + subsequently
- benefit adjustment according to preceding year's *net* wage development
- federal subsidies increased to 20% of the scheme's annual expenditure (permanently)
- all provisions to retire before age 65 without benefit reduction phased out in 2012 (exception: seriously handicapped workers); permanent deduction: 0.3% per month
- credits for periods of schooling and tertiary education reduced: from max. 13 yrs. to 7 yrs. at max. 75% of average wages
- 4 instead of 5 first yrs. of covered employment revalued at 90% of average wages
- child-care credits for births after 1991 increased: 3 yrs. at 75% of average wage (formerly: 1 year)

Growth and Employment Promotion Act 1996 (WBG) – legislated: 1996; effective: 1997 + subsequently
- phasing-out of first benefit receipt without permanent deduction before age 65 accelerated (completion: December 2004 instead of December 2012)
- credits for periods of schooling and tertiary education after age 17 reduced: from max. 7 yrs. to 3 yrs.
- 3 instead of 4 first yrs. of covered employment revalued at max. 75% of average wages (formerly: 90%)
- no credits for periods of unemployment and sickness if no benefits from respective social insurance scheme; credits reduced for recipients of unemployment assistance

Pension Reform Act 1999 (PRA99) – legislated: 1997; effectiveness *scheduled* for 1999 and subsequently
- retirement age for seriously handicapped persons lifted from 60 to 63 yrs. (benefits deducted if claimed between 60 and 63 yrs. of age)
- benefit calculation of disability pensions changed to the disadvantage of claimant and requirements for claiming disability pensions as such strengthened
- increase of life expectancy at age 65 taken into account when calculating initial benefit and adjusting current pensions (“demographic factor”)
- credits from simultaneous covered employment can be added to child-care credits whose value is increased from 75 to 100% of average wages

Pension Reform Act 2001 (PRA2001) – legislated: 2001; effective 2002 and later
- benefit adjustment formula incorporates changes of the contribution rate to public pension scheme and to certified private pensions (effect: decreasing replacement ratio)
- survivors' pensions: more comprehensive income test and further impairments
- revaluation of low earnings for parents when child is between 3 and 10 yrs. or additional credits if non-employed while raising 2 or more children below age 10
- special means-tested basic security scheme for old-age and disability pensioners without reverting to children's income support
- tax-subsidized contribution to certified supplementary provision (starting in 2002, gradually increasing to 4% of maximally covered earnings in 2008)
- political action triggered if foreseeable that contribution rate will exceed 20% before 2020 or 22% before 2030 or target replacement ratio falls below 67%